SUPREME COURT, U. S.

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1967

No. 566

ROYAL AMERICAN INDUSTRIES, INC. and
JOHN D. MacARTHUR, *Petitioners*,

v.

DOLORES K. MURPHY, et al., *Respondents*.

REPLY TO BRIEF OF RESPONDENTS

ROBERT M. ERVIN
for
Ervin, Pennington, Varn & Jacobs
305 South Gadsden Street
Tallahassee, Florida

and

Burns, Middleton, Rogers & Farrell
205 Worth Avenue
Palm Beach, Florida

Attorneys for Petitioners

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REPLY TO BRIEF OF RESPONDENTS

This Reply Brief is filed by Petitioners pursuant to Rule 24, Supreme Court Rules. For the convenience of the Court, Petitioners' reply to the Brief of Respondents will be correlated with the portions of the Brief of Respondents to which the reply is directed.

QUESTION PRESENTED

The question presented is not fairly stated, since it is based upon a false premise that the federal question was first raised on the Petition for Rehearing in the Florida Supreme Court. As will be seen from an analysis of the proceedings in the trial court, District Court of Appeal and Supreme Court, the federal

question was first raised in the trial court, was expressly considered by the District Court of Appeal, and was not raised on the petition for writ of certiorari in the Florida Supreme Court since that would have been improper.

STATEMENT

A. The Facts

The facts as stated by Respondents in the "A" portion of their statement are practically identical with those facts stated by Petitioners in their Petition for Writ of Certiorari. Petitioners stated the facts fairly and accurately, and since Respondents' Statement of the Facts is almost identical, it is apparent that Respondents' critical remarks about the statement are unfounded.

B. The Proceedings in the Trial Court

A vast amount of testimony was presented in the trial court by Petitioners regarding the exempt nature of the transaction under the Securities Act of 1933 and the Securities and Exchange Act of 1934 and the effect of the investment letters which were signed by Respondents at the time of closing. All of this testimony dealt with the Securities Act of 1933 and the Securities and Exchange Act of 1934 and the rules and regulations promulgated by the Securities and Exchange Commission. The complete testimony of William G. Dillon, securities expert who testified on behalf of Petitioners, is contained in Volume III of the Record, pages 43-96. Excerpts from this testimony, consisting of that portion which was given on direct examination, is included herein in Appendix A (R. Vol. III, pages 43-

66; 89-96; Appendix A, pages 14-45). It will be noted that the substance of this testimony was that under federal law, the fact that the stockholders accepted the share certificates bearing the restrictive legend and also executed the investment letters indicated that it was the intention of all of the parties to the transaction that this was a *private offering*, not requiring registration with the Securities and Exchange Commission.

The trial court, in entering its decree in favor of Petitioners, did not rest its decision on the federal question which was raised by the testimony referred to above as to the exempt status of the transaction under federal law. Instead, the Chancellor based his decision on state law, finding that the original contract was subsequently modified by new agreements of the parties as evidenced by Respondents' acceptance of stock certificates with the legend on each restricting tradeability and the simultaneous execution by Respondents of investment letters acknowledging that each Respondent had received the stock for investment purposes with no present intention of selling or otherwise disposing of the same. The Chancellor further concluded that this modification of the contract altered the condition in the original contract with reference to the stock being fully tradeable as well as the time element of registration. This discharged Petitioners from the responsibility of paying Respondents Two and 50/100 Dollars ($2.50) per share for their 439,768 shares of Royal American stock as sought by Respondents. (R. Vol. I, pages 107-108; Appendix B of Petition for Writ of Certiorari, pages 26-27.)

It is true that the Final Decree was devoid of any reference to federal law since the Chancellor bottomed his decision on Florida law without reaching the federal question. However, it is not true, as Respondents would lead this Court to believe, that the federal question was not raised and asserted very

strongly in the trial court. The testimony of William G. Dillon, attached hereto in Appendix A, squarely refutes this statement of Respondents.

C. The Proceedings in the District Court of Appeal

Since the Chancellor had not based his decision on the federal question, the Respondents (Appellants in the District Court) did not raise this issue in their appeal. Having failed to raise this issue on their appeal, it would have been improper for Petitioners (Appellees in the District Court) to raise the issue in their brief since proper appellate practice dictates that appellees' brief is to be responsive to the brief of appellants. Hence, the federal question as raised in the trial court was not briefed nor argued in the appellate court. Petitioners have not yet had a hearing nor opportunity to brief the federal question on its merits at the appellate level.

The District Court, in reversing the Chancellor, did *not* base its decision upon applicable Florida law, as Respondents have asserted in their brief. Indeed, reference to the opinion of the District Court of Appeal will disclose that the District Court attempted to inquire into and interpret the Securities Act of 1933 and the Securities and Exchange Act of 1934 and came up with a holding that:

> "Under the circumstances the contract of August first could have been closed by delivery and exchange of the stock only in violation of the Securities Act, supra, in that it had not been registered in compliance with either of the said acts. The receipt reciting an intention not to dispose of said stock was executed at the request of Royal American in an effort to avoid such violation." (R. Vol. IV, pages

1-5; Appendix B of Petition for Writ of Certiorari, page 22.)

The District Court, having reinjected the federal question into the case on appeal, notwithstanding that the only issues before the appellate court dealt with state law, and having pronounced its ruling as to what it deemed to be a proper application of federal law, then summarily dismissed or ignored the real efficacy of the investment letters by holding that they were merely executed at the request of Royal American in an effort to avoid a violation of federal law. Furthermore, the District Court, while recognizing that the transaction could qualify for the private offering exemption only "if it could be said that the securities were acquired by the purchasers for purpose of investment and with no present intention to dispose of same" (R. Vol. IV, Page 4, Appendix B of Petition for Writ of Certiorari, page 22), nevertheless held that this "investment intent" need not be a bona fide intent to hold the securities for an indefinite period, but that an intent to hold the securities for a six (6) months period pending registration would suffice (R. Vol. IV, pages 3-4; Appendix B of Petition for Writ of Certiorari, page 21).

Thus, it may be seen that, contrary to the assertion by Respondents, the District Court of Appeal bottomed its decision squarely upon the substantial federal question of the legal effect of the federal securities law on the closing of this stock transaction. Since this was done by the District Court without the benefit of briefs or argument of counsel on the federal question, Petitioners have been denied due process of law as guaranteed to them by Section 1 of the Fourteenth Amendment to the United States Constitution.

D. The Proceedings before the Supreme Court of Florida

Petitioners did not raise the federal question in their Petition for Writ of Certiorari to the Supreme Court of Florida as that Petition was directed solely to showing jurisdiction in the Supreme Court of Florida under the Florida Constitution governing conflict certiorari.[1] Indeed, the Florida Appellate Rules, Rule 4.5c(6), provide that the petition shall be directed solely to the issue of jurisdiction, without going into the merits of the cause. Since there were no other Florida cases construing the Securities Act of 1933 and Securities and Exchange Act of 1934 relative to a question such as was involved in the case at bar, there was no conflict in the area of federal law with respect to Florida court decisions, and it would have been improper to raise the federal question there. Petitioners' petition to the Supreme Court of Florida was solely within the ambit of the Florida Constitution and Florida Appellate Rules regarding conflict certiorari.

The Florida Supreme Court, holding that it lacked jurisdiction over the cause (in that the decision of the District Court was not in direct conflict with any decision of another Florida District Court of Appeal or of the Supreme Court of Florida on the same point of law), denied Petitioners' application for a writ of certiorari (R. Vol. IV, page 7). When Petitioners filed their Petition for Rehearing to the Florida Supreme Court, they elaborated on the substantial federal question involved, not "as

1. Article V, Section 4 of the Florida Constitution provides, in part, as follows:

"The Supreme Court may review by certiorari any decision of a District Court of Appeal...that is in direct conflict with the decision of another District Court of Appeal or of the Supreme Court on the same point of law... ."

a last resort", but rather in an attempt to demonstrate to the Supreme Court of Florida that the District Court had erred grievously with respect to a substantial federal question. As previously noted, the Florida Supreme Court denied the Petition for Rehearing without opinion, based upon lack of jurisdiction. (R. Vol. IV, page 8.)

REPLY TO RESPONDENTS' "REASONS FOR DENYING THE WRIT"

1. THE FEDERAL QUESTION WAS FIRST RAISED IN THE TRIAL COURT BY EXTENSIVE TESTIMONY OF PETITIONERS, AND WAS ALSO EXPRESSLY CONSIDERED AND PASSED UPON BY THE DISTRICT COURT ON APPEAL.

This is more than adequate, therefore, to provide a basis upon which this Court has jurisdiction to review a decision of a state court.

Petitioners' contention that the federal question was properly and timely raised in the trial court is amply borne out by a review of the testimony of William G. Dillon, expert securities attorney, as set forth in Appendix A herein. The fact that the trial court based its decision on non-federal grounds is wholly insufficient to deprive this Court of its jurisdiction to review the decision of the state court. This Court has held that on Petition for Certiorari to review a decree of a state court as denying or not duly recognizing a federal right set up therein, it is the Supreme Court's province to inquire not only whether such right was denied in direct terms, but also whether it was denied in substance and effect by interposing a non-federal ground of decision. *Ancient Egyptian Arabic Order of Nobles of the*

Mystic Shrine v. *Michaux*, 279 U.S. 737, 49 S.Ct. 485, 73 L.ed. 931 (1929). Thus, the fact that the federal question was timely presented to the trial court is sufficient in and of itself to give this court jurisdiction to review the cause.

However, there is another and perhaps more compelling circumstance to support Petitioners' position. As set forth above, it is apparent that the District Court re-injected the federal question on appeal and expressly considered it there, even though neither of the parties briefed this point for it. This Court has also held that where federal questions are passed on by state appellate courts, it is immaterial whether the federal questions were raised in the state's trial court. *Home Insurance Company* v. *Dick*, 281 U.S. 397, 50 S.Ct. 338, 74 L.ed. 926 (1930). This case, and others of similar import, constitute a well-recognized exception to the rule which Respondents have asserted as a rigid rule governing the jurisdiction of this Court. As a matter of fact, one of the cases cited by Respondents on page 8 of their Brief actually supports Petitioners' position since it, too, involved exceptional circumstances similar to those in the case of *Home Insurance Company* v. *Dick*, supra. In the case of *Whitney* v. *California*, 274 U.S. 357, 47 S.Ct. 641, 71 L.ed. 1095 (1927), the plaintiff in error had been convicted of violation of a state law, and her conviction had been affirmed by the District Court of Appeal of California. The case was then brought to the United States Supreme Court on Writ of Error, and on the first hearing in the United States Supreme Court, the Writ of Error was dismissed for want of jurisdiction. 269 U.S. 530, 46 S.Ct. 22, 70 L.ed. 396. Thereafter, Petition for Rehearing was granted by the Supreme Court and the case was again heard and reargued both as to the jurisdiction and the merits.

On reargument, the state of California again urged that the federal question had not been timely presented to the trial court.

This Court stated the general rule to be as set forth on page 8 of Respondents' Brief. However, the Court went further and noted that in the *Whitney* case, supra, a certificate had been obtained from the state appellate court indicating that it had considered and necessarily decided the federal question. The court then held that the *Whitney* case, supra, fell within the exception to the general rule, and further held that since the federal question was considered and passed upon by the state appellate court, the U.S. Supreme Court had thereby acquired jurisdiction under the Writ of Error. 274 U.S. 357 at 362. In support of this holding, the Supreme Court cited a long line of cases applying the exception to the general rule.

Respondents' first point that the federal question was not timely raised is wholly without merit. It was expressly raised in the trial court, and the District Court of Appeal expressly considered and passed upon the question, thereby giving this Court jurisdiction to review the case.

2. and 3. THERE IS A SUBSTANTIAL FEDERAL QUESTION OF GREAT PUBLIC IMPORTANCE INVOLVED IN THE CASE AT BAR.

Although Respondents have treated these as two separate points in their Brief, because of the close interrelationship between the points, coupled with the fact that Petitioners covered these points more than adequately in their original Petition, Petitioners' reply will be directed to the two points jointly.

In the United States today, literally thousands of securities transactions take place each day. If the transaction involves any interstate communication or use of the mails, the Securities Act of 1933 requires that the securities involved be registered with

the Securities and Exchange Commission prior to the transfer, with certain exceptions or exemptions. As Petitioners pointed out in their original Petition, the "private offering exemption" has come to be the most widely used exemption in the federal securities laws. Furthermore, the investment letter, as involved in the case at bar, has come to be an integral feature of private offerings.

It was never intended that investment letters should be used by individuals as a ruse or as a device to circumvent federal laws regarding registration. When used properly, as set forth in more detail in the original Petition for Writ of Certiorari, the investment letter is entirely legal and proper so long as the transferee takes the stock with a bona fide intent to hold the same for investment purposes with no present intention of selling or otherwise disposing of same.

Both the federal courts and the Securities and Exchange Commission have expressly held that where a purchaser of securities under an investment letter acquires the securities with an intention to hold them for the six (6) months "capital gains period", or to hold them for deferred sale, or to hold them for a market rise, or to hold them for one (1) year does not constitute a statutory basis for the private offering exemption from the registration requirements of the 1933 Act. *Gilligan, Will & Co.* v. *Securities and Exchange Comm'n.*, 267 F.2d 461 (2d Cir.) *cert. denied*, 361 U.S. 896 (1959); *Re: The Crowell-Collier Publishing Company*, SEC Securities Act Release No. 3825 (August 12, 1957).

The decision of the District Court of Appeal of Florida is diametrically opposed to these federal decisions and, if allowed to stand, would most assuredly create a dangerous precedent in the field of securities exchanges and would at the same time

impute to both Petitioners and Respondents an intent to commit an unlawful act at the time that the exchange of stock was consummated.

For the foregoing reasons, together with the reasons set forth in the Petition for Writ of Certiorari, this Petition should be granted.

Respectfully submitted,

Robert M. Ervin
for
Ervin, Pennington, Varn & Jacobs
305 South Gadsden Street
Tallahassee, Florida

and

Burns, Middleton, Rogers & Farrell
205 Worth Avenue
Palm Beach, Florida

Attorneys for Petitioners